City of Lincoln Nebraska
Police and Fire Pension
Summary for 11/04/99 Advisory Committee Meeting

Members Present: Dennis Duckworth, Al Berndt, Al McCray, Ross Hecht, Jim George, Aaron Drake.
Members Absent:
City Staff: Georgia Glass, John Cripe, Paul Lutomski, Don Herz
Others: Jeff Gottbreht, Dave Engler

Dennis Duckworth: Meeting is called to order. Paul will you go over the agenda?

Paul: Item 1A is to approve August minutes as amended?

Jim George: So moved.

Ross Hecht: Second.

Dennis Duckworth: All in favor? All ayes. Opposed? (silent) Motion carries. Recent activities Paul?

Paul D. Lutomski: Item 1B: Security transactions since last meeting are listed on packet page 2. There are a lot of transactions. They are due to implementing the equity purchase plan. There were three treasury strips sold as well as shares of Vanguard's Index Trust 500 and Extended Market Portfolio sold to buy shares of Vanguard's Total Stock Market Index. The plan is going fine. We sell bonds a few days ahead, put the money in a repurchase pool, instruct the treasurer to wire transfer funds to the pension money market accounts at American Funds and Vanguard, and then call them to buy shares in the equity funds detailed in the plan. Next Item C: Is a letter of agreement regarding changing how the pension calculated "average monthly base pay" and to check if it makes sense to include a member's final check in their Highest 26 pension base.

John Cripe: To sign the letter we need five originals, since Mark Stahlhut is not here the other people could sign it now and Mark could sign later. We were hoping to get this instituted on January 1, 2000.

Jeff Gottbreht: My name is spelled incorrectly.

Paul Lutomski: We'll fix that. Maybe we can have a special meeting to sign these.

Georgia Glass: Are there any concerns or questions on the agreement?

Paul Lutomski: Why don't we let everyone read this, call with questions, and we'll get everyone together later to sign it.

Georgia Glass: Sometime before the year 2000.

Paul Lutomski: Right. Item D. There is a new network access charge of $125 per network socket from information services. The pension has four sockets. John and my computers and printers. When you add in with central services the pension pays about $23,000 each year to the Finance department.

Item E. We received notice of a Phillip Morris Class action due to the company's dissemination of false and misleading statements regarding the addictive nature nicotine. The pension purchased 1700 shares from 6/22/93 thru 12/29/93 and sold all on 3/17/94,for a profit of $8,259.85 on $86,000.50 invested. Possible settlement of $2.19 per share, or $3,723.00. We report back when we hear the resolution of this.

Item F. Page 6-8: Annual Actuarial financial and demographic data submitted. $116 million August 1999 Actuarial assets value was approximately equal to August 1998 asset value. Pension liabilities continued to increase and therefore overfunding is expected to decrease from $14 million to $10 million. Decreased overfunding means the actuary will recommend an approximate 40% increase in recommended minimum City contribution (from $1.07 million to $1.5 million*). Currently the City is contributing $866,514.* However, since the pension is not at level funding yet, the City is not violating any GASB pension funding guidelines. Once at level funding the City will need to contribute the minimum recommended rate, or risk a lower bond rating.

John Cripe: We may have the next actuary report by our February meeting. This is just an estimate of what that report may contain. Do you want me to talk about item G?

Paul Lutomski: Yes.

John Cripe: For some time we have been talking about the possibility of another switch option. Members will be given the opportunity to switch from Plans B and C, to Plan A. Educational materials and meetings will precede a 3 month "Switch Window" maybe in the summer of 2000. To switch a member must pay the difference between 8% contributions since April 1, 1995 to their switch date, and their actual contributions for the same time period. No interest on the contributions will be required. For example, if a member opted to switch on April 1, 2000, had a average annual base salary of 40,000 and contributed 7.6% from April 1, 1995 to April 1, 1997 and then contributed nothing, they would need to pay the pension .4% for two years and 8% for 3 years, or $9,920. If the committee agrees that this should be pursued a motion could be made.

Jim George: Motion.

Al McCray: Second.

Ross Hecht: What's the cost to the City?

John Cripe: Based on our discussions with the actuary it appears to be neutral.

Ross Hecht: What if it isn't?

John Cripe: We absorb the cost.

Aaron Drake: How would you make people pay back the contribution difference?

John Cripe: The cost to switch, for people that are still contributing, is nominal. If a person has stopped contributing the cost would be high. We would accept a check for the full amount.

Aaron Drake: Would you give them time to pay?

John Cripe: There will be the time during the educational period and the sign up period to collect the funds for the 3 month switch period. This should give people time to plan and arrange funds.

Jim George: If a person that chose to switch were beyond age 50 and 25 years of service, would he be required to contribute beyond that date when he attained those.

John Cripe: Yes, because the 8% plan requires contributions until retirement. That person would be immediately eligible for retirement at the higher rate.

Paul Lutomski: We still have a motion to vote on.

Dennis Duckworth: All in favor? ? All ayes. Opposed? (silent) Motion carries.

John Cripe: Item I begins with a summary on page 9. These are the 6 DROP alternatives. Alternative 1 has a DROP eligibility of age 50 and 21 YOS for all plans. This alternative will decrease overfunding by $3.31 million and increase annual normal cost by .95%. Alternative 2 has the same structure but is cost neutral because the DROP percent is changed from 100% to 80%.

Alternative 3 has a DROP eligibility of age 50 and 21 YOS for the B and C plans and age 50 and 25 YOS for plan A. This alternative will decrease overfunding by $3.28 million and increase annual normal cost by .91%. Alternative 4 has the same structure but is cost neutral because the DROP percent is changed from 100% to 85%.

Alternative 5 has a DROP eligibility of age 53 and 21 YOS for the B and C plans and age 50 and 25 YOS for plan A. This alternative will decrease overfunding by $2.4 million and increase annual normal cost by .61%. Alternative 6 has the same structure but is cost neutral because the DROP percent is changed from 100% to somewhere between 87% and 90%.

Alternative 7 is like alternative 6, but it specifies a different DROP percent for Plan A, B and C. We are waiting on these figures. I expect the Plan A DROP percent to be about 100%, and Plan B and C to be around 85-90%.

Jim George: Don’t Plan A members benefit the most from the DROP plan?

John Cripe: Yes, because Plan A is a traditional defined benefit plan, and the DROP was originally designed for a traditional Defined Benefit plan.

Jim George: Plan B and C members have to give up their refund to get into the DROP, which makes them like Plan A, but they are getting a lesser DROP percent. That’s not right.

John Cripe: Plan B and C members stop contributing after 21 years and Plan A members continue for their career. During the DROP no one would contribute, this will save the Plan A member 8%, but saves the B and C members nothing because they weren’t contributing anyway. Plan B and C member’s pension benefit is increasing 2% per year whereas the Plan A member is maxed out at 64%. We would like to be able to offer all three at 100%, but its not realistic to expect the City Council to pass something that costs $2.4 million up from and $410,000 every year after that.

Aaron Drake: Could there be problems between employees because of the three different DROP rates?

John Cripe: If the unknown alternative 6 neutrality DROP percent is your recommendation I would have no problem with that.

Jim George: Different actuaries may look at the cost differently. Could we get a second opinion?

Georgia Glass: When you talked to your actuary did you describe our plan?

Jim George: No. His only comment was that different actuaries look at the same thing differently. That they do a lot of DROP plans. I would like to have a second opinion.

Georgia Glass: I did call this gentlemen you recommended. He said we had a well respected actuary company and that a 5 year DROP plan costs less than a 3 year plan. That was it. What was your conversation Paul?

Paul Lutomski: He said he would look at Gabriel Roeder's report for a fee. He couldn't give a figure until he saw how complex, or not, the report was. He agreed that in order to get a second opinion rather than a review, he would need to have all the data that Gabriel Roeder has and start from scratch.

Georgia Glass: The question is if we want to take the time, and spend the money, to get a second opinion. If their answer is different are we prepared to completely change actuaries, because our actuary will apply their own numbers if the DROP is adopted.

Jim George: I thought there was some discussion if we wanted to continue to use Gabriel Roeder?

John Cripe: We have been frustrated over the delays in the last few months. Prior to that we have been happy with their service. We talked to them about that. The person assigned to us was promoted and has now assigned our plan to another person that is not as familiar with our plan.

Jim George: By far most DROP plans are 100%.

John Cripe: That has to do with plan design.

Jim George: Can they show us what makes our plan design more costly?

John Cripe: Stopping contributions after 21 years.

Paul Lutomski: Our actuary tells me that to get cost neutral the most common way is for a reduced DROP percent. Another way is for the employee to continue contributing.

Jim George: When we talked about a reduced DROP it was not well accepted.

John Cripe: To bring this discussion to a close, if possible, we want to stress this is just another option. We are not making employees chose this option. If it is not something they think will benefit them they do not have to choose it. In order to offer it as an option we have to know it is cost neutral.

Jim George: If I had a second opinion stating Gabriel Roeder's numbers are correct I would be comfortable. I'd be convinced.

Georgia Glass: Lets talk about the right thing to do.

Ross Hecht: We employed a second actuary to review the primary one. It wasn't all that expensive and gave us some peace of mind.

Jim George: I have talked with ICMA. The person I talked to said all the DROP plans they administer are 100% DROPs. They gave me the name of the actuary they use.

Aaron Drake: Let's call the second actuary and ask for a price. If the price is reasonable we could consider going ahead with it.

John Cripe: The cost will depend on what we ask them to do. A review will be less expensive than starting from scratch. To re-do the whole thing will take a lot of time and dollars.

Georgia Glass: Shall we call the actuary, lay out some different levels of review, and ask them how long and how much each will cost?

Aaron Drake: What have we paid this actuary?

Paul Lutomski: $5,775 for alternative 1, they estimate another $2000 total for the other 6 alternatives.

Don Herz: Given the same assumptions and calculation methods the second actuary should validate the first by computing an answer close to the original. There is always that possibility they will not agree even given the same inputs. That might be a problem.

Georgia Glass: It seems we should talk more to this guy.

John Cripe: Why don't we call, and get some cost and time ideas, and get back together in a couple weeks to discuss taking some action one way of another. We should also have the alternative 6 DROP percent by then. I want to move forward as soon as we can.

Georgia Glass: Yes. Thursday November 18th 3 p.m. here.

Paul Lutomski: The next item is Investment Strategy. Currently the pension has $280,000 in the repurchase pool and $78,214.23 in cash. For the next 3 months no funds are expected to be available for investment. The next maturing investment is a $180,000 TSTRIP on 8/15/2000.

Page 31 shows a maturity graph with values at the earlier of call date, principle begin pay date (for accrual tranche and interest paying CMOs), or maturity date. Please note that:

- T-STRIPS (in green) are $180,000 in year 2000, then start again in 2006 - 2019.
- Agency Zeros (in black) purchased April '99 and May '99 have call dates in 2001 and 2002.
- Bonds are laddered from the year 2001 to 2007, with a spike in year 2003.
- CMOs are shown in gray from 2005 – 2007, 2010 – 2011 and 2018.

$937,500 is needed for each of the next three months for equity purchases according to the Equity Investment Plan. Spreads to treasury issues are becoming tighter, but are still at historically high levels. It is not a good time to sell non-treasuries, because as spreads tighten the price of the non-treasury issues increases. Pages 28-29 are the Portfolio GRADE report NBC runs on their Bloomberg system. It estimates price increase/decrease for each pension security for basis point shifts from +300 to –300. (left 4 columns) For example, the lowest price increase corresponds to the treasury STRIP due 8/15/2000 at 1% for a 100bp downturn in interest rates. The highest price increase at a 100bp downturn, is for a treasury STRIP maturing 2/15/2018, at 19%. Finally, due to the equity purchase program the pension and the fact that it is not a good time to sell agencies, the pension is in violation of the Investment Policy asset allocation guidelines.

Our recommendation is to continue with the program of selling Treasuries begun in August. The equity investment program will require selling assets to enable a $937,500 investment each month through July of 2001.

According to the Bloomberg report, at a 100 bp downturn, T-bonds due 02/15/03 have a 3% price appreciation potential. This is the fourth lowest on the report. Sell $1.2 million of these Treasury bonds to fund November's equity purchase, and increase cash reserves for unexpected retirement pay outs, and to compensate for lost coupon interest from selling the T-bonds in this recommendation.

According to the Bloomberg report, at a 100 bp downturn, T-bonds due 08/15/01 have a 2% price appreciation potential. This is the second lowest on the report. Sell $.8 million Treasury bonds with cusip 912810CW to fund December's equity purchase.

According to the Bloomberg report, at a 100 bp downturn, T-bonds due 11/15/02 have a 3% price appreciation potential. This is the third lowest on the report. Sell $.8 million Treasury bonds with cusip 912810DA to fund January's equity purchase.

We also recommend changing the investment policy, either permanently or temporarily, so the pension is in-line with the policy. The suggested change is section IV.E.2. as follows:

> ~~90%~~ 70% of debt securities must be guaranteed as to the timely payment of principal and interest by the U.S. Government, its agencies or instrumentalities.

Ross Hecht: Could you draft a position paper that we could sign to allow a temporary waiver of the investment policy while the equity purchase is implemented?

John Cripe: Sure. Would you be willing to pass a temporary waiver until we can prepare the position paper at next quarter's meeting?

Ross Hecht: So Moved.

Jim George: Second:

Dennis Duckworth: All in favor? All ayes. Opposed? (silent) Motion carries.

Aaron Drake: Recently we discussed raising the minimum for elderly retirees. John, you mentioned the possibility of raising everyone a certain percentage based on the length of their retirement. One concern is with that is that we are committing to this for a tremendously long time for some people. Whereas if the minimum were raised, this would be self correcting in a much shorter time. My concern with raising the minimum was where to draw the line. Its shameful to have folks earning $350, whether they are regular retirees or deferreds. If we put the minimum at $400 and somebody is paid $410, they just missed out. The percentage method helped those folks who have been retired a long time.

Aaron Drake: But not from a real dollar standpoint. For example, my grandma gets $346. If we gave her the 20% it would come to about an extra $70. Not very much. A person that has been retired for four years might get a bigger increase than she would get because they started out at a much higher base.

John Cripe: What we could do this time is establish a floor and give a percentage. Last time it was ½% for each year retired. It could be a ¼% to help more people by raising the minimum. We think we may be able to fund this increase by using the COLA pool. Currently the pool has $7.5 million in it. Whatever the cost of this increase could be taken from the COLA pool. Doing this will not affect the City's long term normal cost. The $7.5 million is projected to last forever, but we don't want to jeopardize the COLA with this increase.

Jim George: Is that where the funding came from last time?

John Cripe: No. Last time it came from overfunding.

Jim George: Could we take this cost from the overfunding again to protect the COLA pool?

John Cripe: We could, but that's not a good scenario to take to the council.

Jim George: Why are we talking about adding a percentage to people that retired recently when their pension are much higher than the $350 area?

John Cripe: You could restrict this to people retiring more than five years ago. I was not personally comfortable in drawing a line above which no one got an increase.

Aaron Drake: I don't think it should matter how long someone was retired.

Dennis Duckworth: Could we set a floor and then automatically increase the floor in future years?

John Cripe: We can put it on the agenda each year to review the floor. That way the long term cost of the increases would not actuarially come all at once, but rather a little each year.

Dennis Duckworth: If there is not other business I would entertain a motion to adjourn.

Jim George: So moved.

Ross Hecht: Second.

Dennis Duckworth: Any more items for discussion? Meeting Adjourned.